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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 108

ELMER H. BARTLETT ET AL., PETITIONERS

v.

DENIS W. DELANEY, COLLECTOR, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 16-26) is reported at 75 F. Supp. 490. The opinion of the Court of Appeals (R. 57-67) is reported at 173 F. 2d 535.

JURISDICTION

The judgment of the Court of Appeals was entered on March 23, 1949. (R. 67.) The petition for a writ of certiorari was filed on June 9, 1949. The jurisdiction of this Court is invoked under 28 U.S.C., Sec. 1254.

QUESTION PRESENTED

A taxpayer on the cash basis paid interest on a tax deficiency in 1942 and properly deducted the amount so paid in his income tax return for that year. Thereafter it was determined that the deficiency had been improperly assessed, and in 1943 the amount in question was refunded to the taxpayer and included by him in his gross income for that year. Could the taxpayer thereafter amend his 1942 and 1943 tax returns by eliminating the deduction from the former and the inclusion from the latter and, upon the basis of such recomputation, claim a refund of taxes paid on 1943 income?

STATUTES INVOLVED

Internal Revenue Code:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
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> (b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this chapter.
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> * * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

* * * * *

(26 U.S.C. 1946 ed., Sec. 41.)

SEC. 42 [as amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

(26 U.S.C. 1946 ed., Sec. 42.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U.S.C. 1946 ed., Sec. 43.)

STATEMENT

These suits were brought for the refund of income taxes paid for the calendar year 1943 and present a common question of law. They were consolidated for trial (R. 6, 37, 51) and on appeal (R. 31).

The taxpayers were on the cash basis, using the calendar year as their accounting period. During 1937, they received certain shares of stock in Bird & Son, Inc., pursuant to a recapitalization of that company, but they did not report the value of the shares in their 1937 income tax returns. In 1942, the Commissioner asserted that these shares constituted taxable income to the recipients and assessed deficiencies in their 1937 income taxes. The taxpayers paid the deficiencies, with interest, during 1942 and claimed deductions for the interest

payments in their income tax returns for that year. (R. 11, 16.)

However, a judgment rendered in 1942 in a parallel action[1] instituted by another stockholder of Bird & Son, Inc., determined that shares such as those received by taxpayers in 1937 were not taxable to the recipients. Following that decision, the taxpayers filed, during 1942, claims for refund of the 1937 deficiencies, and in 1943 the United States refunded the overpaid tax and interest.[2] The interest refunds were reported by taxpayers as income received in 1943. Thereafter, they filed claims for refund of 1943 income taxes, contending that so long as the years 1942 and 1943 were still open for adjustment, the proper tax treatment of the transactions was to redetermine the tax for those years by expunging the "interest paid" deductions taken in 1942 and eliminating from 1943 gross income the interest refunds. (R. 16-17.)

The District Court upheld the Collectors' contention that the 1942 deductions should stand and that the interest refunds should be returned as income in 1943. (R. 18-26.) The Court of Appeals affirmed.

ARGUMENT

The Court of Appeals correctly decided the case on the authority of *Security Mills Co.* v. *Commis-*

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[1] *Bass* v. *Commissioner*, 129 F. 2d 300 (C.A. 1st).

[2] Taxpayers also received interest on the amounts refunded. These items of interest were conceded to be income in 1943 and are not in issue.

sioner, 321 U. S. 281, and there is no reason for further review.

1. The right of a taxpayer to adjust his income tax liability by a timely claim for refund is qualified by the fundamental policy of the revenue laws to impose income taxes on a yearly basis. As this Court pointed out in the *Security Mills Co.* case (pp. 286-287):

> The rationale of the system is this: "It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation."
>
> This legal principle has often been stated and applied. The uniform result has been denial both to Government and to taxpayer of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment, or, applying the accrual basis, the year in which the right to receive, or the obligation to pay, has become final and definite in amount.

Consequently, when a deduction for interest paid is properly taken in one year, neither the taxpayer nor the Commissioner may thereafter recompute the tax for that year by expunging the deduction because the interest is refunded in a later year.

That the deductions were proper when claimed by taxpayers in 1942 does not seem to be disputed. The 1937 deficiencies having been duly assessed by the Commissioner, the obligation to pay the additional taxes and interest became fixed and certain. When taxpayers discharged their obligations by payment, they became entitled to deductions for the interest paid even though they later in the year filed claims for refund. *Chestnut Securities Co.* v. *United States,* 62 F. Supp. 574 (C. Cls.). The deductions were no less allowable in 1942 because the decision in *Bass* v. *Commissioner,* 129 F. 2d 300 (C.A. 1st), had become final in that year, effectively foretelling the subsequent reversal by the Commissioner of his action in including in taxpayers' 1937 income the stock received in the Bird & Son, Inc., recapitalization. At best, taxpayers in 1942 had only an unripened right to receive refunds, since their claims had not been allowed and suits could not yet be instituted on the claims.[3] Moreover, despite the fact that the Commissioner erred in basing the deficiencies on inclusion of the Bird stock in income, there was no assurance that taxpayers would receive refunds, since the right to recover taxes paid depends not on whether the method of determining the assessment is correct, but on whether the assessments themselves are right. *Lewis* v. *Reynolds,* 284 U. S. 281; *Reinecke* v. *Spalding,* 280 U. S. 227, 232. The

[3] The refund claims were filed on December 1, 1942.

decision in *Bass* v. *Commissioner, supra,* decided only that the Commissioner's method of determining taxpayers' liability was wrong; it did not establish that there had been overpayments.[4] That fact could be determined only by a final audit of taxpayers' returns, and until then taxpayers could not accrue the refunds, much less treat them as having been made.

Therefore, the court below correctly assumed (R. 67) that the deductions were properly claimed in 1942. It follows that the only effect of the subsequent refunds was to require taxpayers to include the refunded interest in income for the year of receipt. *Rothensies* v. *Electric Battery Co.,* 329 U. S. 296, 298.

2. It is true that *Security Mills Co.* v. *Commissioner,* 321 U. S. 281, involved an accrual basis taxpayer and that the attempted adjustment differed in that taxpayer sought to project back a payment rather than a receipt. However, there is no difference in principle whether the taxpayer is on the cash basis or the accrual basis, or whether the adjustment deals with an outgo or a receipt of income. In either case, calculation of tax liability must be made on the basis of facts occurring in the taxable year rather than in light of circumstances arising in a later year. *Security Mills Co.* v. *Com-*

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[4] Thus, in the case of one of the taxpayers, the reduction of gross income by exclusion of the Bird stock was partially offset by additions of other items to income.

missioner, supra; North American Oil v. *Burnet,* 286 U. S. 417; *Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359.

Francis v. *Commissioner,* decided April 15, 1949 (1949 P-H T.C. Memorandum Decisions Service, par. 49,086), *Greenwald* v. *United States,* 57 F. Supp. 569 (C. Cls.), and *Wells* v. *United States,* 64 F. Supp. 476 (C. Cls.), cited by taxpayers (Br. 14, 15), are not inconsistent. In the first two of these cases the adjustments were based on facts as they existed in the tax year and not as a result of subsequently occurring events. In the *Wells* case, the court found that the money was paid to taxpayer as an advance, and that in consequence the "claim of right" doctrine announced in *North American Oil* v. *Burnet, supra,* had no application.

Gargaro v. *United States,* 73 F. Supp. 973 (C. Cls.), also cited by taxpayers (Br. 14), was a decision on the Government's demurrer and involved no final judgment or decree which could be reviewed. *Standard Steel Car Co.* v. *United States,* 61 C. Cls. 391. Following overruling of the demurrer, the case has been set for hearing on the merits and is now pending.

3. Taxpayers' contention (Pet. 5-6) that the decision here is in conflict with *Cooperstown Corp.* v. *Commissioner,* 144 F. 2d 693 (C.A. 3d), certiorari denied, 323 U. S. 772, amounts in essence to a repetition of the argument advanced in the petition for certiorari in the latter case that the deci-

sion there conflicted with *Security Mills Co.* v. *Commissioner,* 321 U. S. 281. As the court below pointed out (R. 66), the *Cooperstown* case is distinguishable from the *Security Mills* case and from this one for the reasons stated by the Government in opposing the petition in the *Cooperstown* case. In that case, the tax had not been assessed by the Commissioner, and demand had not been made by the Collector. The tax had been voluntarily computed and paid by the taxpayer, and it was on this ground that the right to the deduction was denied. The court held (144 F. 2d 693, 696) that in the absence of liability during the tax year, the deduction should be denied, distinguishing *Stanard-Tilton Milling Co.* v. *Commissioner,* 3 T. C. 1026, where deduction was allowed for taxes assessed and paid during the tax year although refunded in a later year. The situation here is indistinguishable from *Security Mills Co.* v. *Commissioner* and *Stanard-Tilton Milling Co.* v. *Commissioner.* It is unlike *Cooperstown Corp.* v. *Commissioner,* and the reasons for denial of certiorari in the latter case are equally applicable here.

CONCLUSION

The decision of the Court of Appeals is in harmony with decisions of this Court, and there is no conflict with other Circuits. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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